

**LEGISLATIVE SERVICES AGENCY  
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS**

200 W. Washington, Suite 301  
Indianapolis, IN 46204  
(317) 233-0696  
<http://www.in.gov/legislative>

**FISCAL IMPACT STATEMENT**

**LS 6127**

**BILL NUMBER:** HB 1134

**NOTE PREPARED:** Dec 30, 2006

**BILL AMENDED:**

**SUBJECT:** Tax Deduction for Federal Retirement Benefits.

**FIRST AUTHOR:** Rep. Cherry

**FIRST SPONSOR:**

**BILL STATUS:** As Introduced

**FUNDS AFFECTED:** ☒ **GENERAL**  
☒ **DEDICATED**  
**FEDERAL**

**IMPACT:** State & Local

**Summary of Legislation:** The bill provides an Adjusted Gross Income Tax deduction for part of a federal government pension (including a military pension) received by an individual or an individual's surviving spouse, in an amount that does not exceed the difference between: (1) the maximum benefits payable under Social Security that could have been excluded from the individual's federal gross income for the year; and (2) the Social Security benefits actually received by the individual during the year. The bill provides that a taxpayer may not claim both this deduction and the existing military service deduction or federal civil service deduction.

**Effective Date:** July 1, 2007.

**Explanation of State Expenditures:** The Department of State Revenue (DOR) would incur some administrative expenses relating to the revision of tax forms, instructions, and computer programs to incorporate the new military and civil service pension deduction. The DOR's current level of resources should be sufficient to implement these changes.

**Explanation of State Revenues:** *Summary:* The bill would reduce Adjusted Gross Income (AGI) Tax liabilities of individual taxpayers who receive military or federal civil service retirement benefits. The precise revenue loss due to the bill is indeterminable because data is unavailable to determine the potential offsetting effects of Social Security benefits the taxpayer receives and the maximum amount of Social Security benefits the taxpayer could exclude from federal gross income. (Note: The difference between the taxpayer's maximum excludable Social Security benefit amount and the excludable Social Security benefits the taxpayer actually received during the tax year is the amount of military or federal civil service retirement benefits the taxpayer may deduct from AGI.)

If all military and federal civil service retirement benefits not already claimed under current law deductions is deducted under the provisions of the bill, it could potentially reduce revenue from the Adjusted Gross Income (AGI) Tax by as much as \$32.6 M in FY 2009, with annual growth in the revenue loss of about 1.5%.

*Background Information:* This bill provides an Individual AGI Tax deduction for recipients of military or federal civil service retirement benefits beginning in tax year 2008. The bill permits a taxpayer to deduct the amount of military or civil service retirement benefits included in the taxpayer's federal AGI. However, the deduction may not exceed: (1) the amount of retirement benefits received by the taxpayer that would have been tax-exempt if they had been treated as Social Security benefits; minus (2) the amount of Social Security benefits actually received by the taxpayer that are tax-exempt. The bill prohibits a taxpayer from claiming both the AGI deduction established under the bill and the existing AGI deductions for military and federal civil service retirement benefits. Since the bill is effective beginning in tax year 2008, the fiscal impact would begin in FY 2009. Eighty-six percent of the revenue from the AGI Tax on individuals is deposited in the state General Fund, and 14% of the revenue is deposited in the Property Tax Replacement Fund.

The typical maximum excludable Social Security benefit for taxpayers who receive military or federal civil service retirement benefits is indeterminable. In addition, no data is available which indicates the Social Security benefit typically obtained by individuals who receive military or federal civil service retirement benefits.

Civil Service Annuities: Under current statute, taxpayers may deduct up to \$2,000 in civil service annuity income. State tax return data indicates that 4,159 taxpayers deducted approximately \$7.3 M in civil service annuity pay from AGI in 2004. This amount resulted in a revenue loss of about \$250,000. From 2000 to 2004, this deduction declined by an average of 1.2% per year. Data from the U.S. Office of Personnel Management indicates that there were about 26,000 federal retirees and about 8,800 surviving spouses of federal retirees residing in Indiana in 2006. These individuals received \$740.0 M in civil service annuity payments during 2006. It is estimated that if all annuity payments were deductible, the additional deduction amount could total about \$781.0 M in 2008, with the additional revenue loss from a full deduction totaling about \$26.3 M.

Military Retirement Benefits: Under current statute, a taxpayer may deduct up to \$2,000 in military service income from state AGI. This includes military retirement, provided the recipient is 60 years old or older. State tax return data indicates that 36,530 taxpayers claimed the deduction for military service pay and retirement benefits in tax year 2004, deducting approximately \$72.5 M in military pay and retirement benefits. This amount resulted in a revenue loss of about \$2.5 M. From 1999 to 2004, this deduction increased by an average of 1.5% per year. Based on U.S. Department of Defense (DOD) military census and pay rate data, it is estimated that about 30% of the annual total amount deducted under the current \$2,000 deduction is attributable to Indiana taxpayers who are 60 years old or older and received military retirement pay during the year. A full deduction for military retirement benefits to these taxpayers could potentially increase the total annual deduction amount by about \$185 M in tax year 2008, with a tax impact of about \$6.3 M.

#### **Explanation of Local Expenditures:**

**Explanation of Local Revenues:** Because the proposed deduction for civil service and military pension benefits would serve to decrease taxable income, counties imposing local option income taxes (CAGIT, COIT, and/or CEDIT) could potentially experience a significant decrease in revenue from these taxes.

**State Agencies Affected:** Department of State Revenue.

**Local Agencies Affected:** Counties with local option income taxes.

**Information Sources:** OFMA Income Tax databases, 1996-2004; Deborah K. Williamson, U.S. Department of Defense, Defense Manpower Data Center, (831) 583-2400; Matthew Torres, U. S. Department of Defense, Defense Manpower Data Center (831) 583-2500; Ed Callicott, Federal Office of Personnel Management, (202) 606-0650; Ellen Holmes, Federal Office of Personnel Management, (202) 606-1782.

**Fiscal Analyst:** Jim Landers, 317-232-9869.